

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

JUNE 11, 2001

IN RE:)	
)	
GASCO DISTRIBUTION SYSTEMS)	DOCKET NO.
ACTUAL COST ADJUSTMENT (ACA) AUDIT)	00-00998

**INITIAL ORDER OF THE HEARING OFFICER DENYING GASCO'S REQUEST TO
DISMISS SHOW CAUSE PROCEEDING**

On May 14, 2001, the Tennessee Regulatory Authority (the "Authority" or "TRA") issued an Order requiring Gasco Distribution Systems, Inc. ("Gasco" or the "Company") to show cause as to why penalties should not be imposed for Gasco's apparent failure to comply with the terms of the Authority's Order of November 24, 1999, in Authority Docket No. 99-00647. This matter came before the Hearing Officer upon Gasco's request to dismiss the Authority's show cause proceeding, which arose from the Actual Cost Adjustment ("ACA") Audit Report (the "2000 Report") by the Authority's Energy and Water Division (the "Staff").

The 2000 Report, resulting from the Staff's compliance audit of Gasco's annual deferred gas cost account filings for the period from July 1, 1999, through June 30, 2000, contained a finding that Gasco failed to comply with the Staff's ACA audit report (the "1999 Report") for the preceding audit period, in Authority Docket No. 99-00647, and the Authority's Order of November 24, 1999, approving and adopting the 1999 report. The Authority ordered Gasco to show cause why the Authority should not impose penalties for such non-compliance. Gasco filed a response to the show cause order on May 25, 2001, and in that response asked that this

matter be dismissed. For the reasons set forth below, the Hearing Officer finds that Gasco's motion is without merit and is hereby dismissed.

Background

On October 23, 2000, the Company submitted to the Authority its ACA filing for the period from July 1, 1999 through June 30, 2000, and the Staff completed its compliance audit of the Company's filing on March 29, 2001. On March 29, 2001, the Staff issued its preliminary ACA audit findings to the Company, and the Company responded to these findings on April 5, 2001. The Staff filed the 2000 Report with the Authority on April 5, 2001. The 2000 Report contains the audit findings of the Staff, the responses thereto of the Company, and the recommendations of the Staff to the Company in addressing the findings.

The 2000 Report lists three (3) specific findings and states that, based on the three (3) findings, the balance in the Company's refund due customers account as of June 30, 2000, should be a negative \$24,084.77. Accordingly, the 2000 Report states, the correct ACA adjustment factor to be applied to customer bills, beginning with the April 2001 billing period, is a negative \$.5017.

In addition to the three (3) specific findings, the 2000 Report states that "[b]ased on Staff Findings in the current audit and the fact that the Company did not remedy the issues in the last audit, we must conclude that Gasco has failed to comply with the Actual Cost Adjustment component of the Purchased Gas Adjustment ("PGA") Rule."¹ The 2000 Report further states that "[t]his adverse opinion is of great concern to the Staff."² The 2000 Report lists three (3) areas in which the Company "has shown deficiency."³

¹ *Compliance Audit Report of Gasco Distribution Systems, Inc., Actual Cost Adjustment*, TRA Docket No. 00-00998, p. 9 (April 5, 2001).

² *Id.*

³ *Id.*

First, the 2000 Report states that Gasco did not file its ACA report until October 23, 2000, 115 days after the close of the audit period. While acknowledging that the Authority's PGA Rule does not specify a time limit for the required annual ACA filing, the 2000 Report cites Authority Rule 1220-4-1-.10(b), which requires gas utility companies to file quarterly or monthly reports, as appropriate, within sixty (60) days after the end of the period covered in such reports. Using this Rule as a standard of reasonableness, the Report concludes that Gasco did not file its ACA report in a timely manner.

Second, the 2000 Report states that in the previous Staff ACA audit of the Company, reflected in the 1999 Report, the Staff advised Gasco that the correct ACA adjustment factor to apply to its customers' bills, beginning with the November 1999 billing, was a negative \$.5915.⁴ The Authority's Order of November 24, 1999, approved and adopted the 1999 Report.⁵ As the 2000 Report states, the Staff's Finding No. 1 revealed that Gasco failed to change its billing system to implement the correct factor in accordance with the 1999 Report. According to the 2000 Report, the Company stated that this factor was not implemented until November 2000, one (1) year after the Authority ordered the change. Therefore, as the 2000 Report states, the "Company was out of compliance for 365 days and could be subject to penalties, as outlined in T.C.A. §65-4-120."⁶ The 2000 Report further notes that the Company was cited for the same

⁴ A negative adjustment is made through a refund to customers.

⁵ *Order Adopting ACA Audit Report of Authority's Staff*, TRA Docket No. 99-00647, p. 2 (Nov. 24, 1999).

⁶ *Compliance Audit Report of Gasco Distribution Systems, Inc., Actual Cost Adjustment*, TRA Docket No. 00-00998, p. 10 (April 5, 2001). Tenn. Code Ann. § 65-4-120 provides that:

Any public utility which violates or fails to comply with any lawful order, judgment, finding, rule, or requirement of the authority, shall in the discretion of the authority be subject to a penalty of fifty dollars (\$50.00) for each day of any such violation or failure, which may be declared due and payable by the authority, upon complaint, and after hearing, and when paid, either voluntarily, or after suit, which may be brought by the authority, shall be placed to the credit of the public utility account.

error in the previous audit and states that such failures “indicate[] a serious flaw in the Company’s internal accounting control.”⁷

Third, the 2000 Report cites the Company’s use of incorrect interest rates for each month of the audit period despite being furnished with the correct rate by letter from the Authority Staff on a quarterly basis. According to the 2000 Report, the Company responded to this finding by stating that one of its employees misinterpreted the Staff’s letter. Nevertheless, the 2000 Report states, “Staff maintains that the letter is very clear as to the rate that applies to the appropriate calendar quarter.”⁸ The 2000 Report notes that the Company was cited for the same error in the previous audit and states that this failure is “an example of extreme carelessness on the part of the Company.”⁹

At the April 17, 2001, Authority Conference, after consideration of the 2000 Report, the Authority unanimously approved and adopted the findings and recommendations contained therein. In addition, in view of the Company’s apparent non-compliance with the Authority’s November 24, 1999, Order in Docket No. 99-00647, the Authority unanimously ordered the Company, pursuant to Tenn. Code Ann. § 65-2-106,¹⁰ to show cause why the Authority should not impose penalties against the Company for such non-compliance. In addition, Director Melvin J. Malone was appointed as Hearing Officer on the merits to consider the Company’s response and possible penalties. The Hearing Officer was authorized to exercise his discretion in determining whether this matter should travel together or in combination with Authority Docket

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ Tenn. Code Ann. § 65-2-106 provides, in relevant part, that

... The authority is empowered and authorized in the exercise of the powers and jurisdiction conferred upon it by law to issue orders on its own motion citing persons under its jurisdiction to appear before it and show cause why the authority should not take such action as the authority shall indicate in its show cause order appears justified by preliminary investigations made by the authority under the powers conferred upon it by law.

Nos. 97-00160 and No. 97-00293,¹¹ which involve similar issues related to Gasco and in which Director Malone serves as Hearing Officer. An Order (the “Show Cause Order”) reflecting these actions was issued on May 14, 2001. The Show Cause Order states that “Gasco is ordered to show cause why the Authority should not impose penalties against it for failure to comply with the Authority’s November 24, 1999, Order in Authority Docket No. 99-00647.”¹²

Pursuant to a Notice issued by the Authority on May 16, 2001, Gasco filed a response (the “Response”) to the Show Cause Order on May 25, 2001. Also pursuant to the May 16, 2001, Notice, the Authority Staff filed a reply (the “Reply”) to Gasco’s Response on June 1, 2001.

Gasco’s Response

In its Response, Gasco states that “[a]lthough the body of the [Show Cause] Order discusses several issues raised by the Staff’s recent audit of Gasco, the Order states no basis for the show cause proceeding other than, as described above, the ‘failure to comply’ with the Authority’s final Order in Docket No. 99-00647.”¹³ With regard to that Order, the Response states:

The Order does not direct Gasco to take, or refrain from taking, any action. In relevant part, it states merely that the staff’s “ACA Audit Report [for the period July 1, 1998 through June 30, 1999] . . . is approved and adopted, including the findings and recommendations contained therein.”¹⁴

With regard to the 1999 Report, Gasco argues: “[s]imilarly, the ACA Audit Report referenced in the [Show Cause] Order does not direct Gasco to take, or refrain from taking, any

¹¹ These are consolidated dockets styled: In Re: Show Cause Proceeding Against Gasco Distribution Systems.

¹² *Order Adopting ACA Audit Report of Tennessee Regulatory Authority’s Energy and Water Division, Ordering Gasco to Show Cause Why Penalties Should Not Be Imposed, and Appointing Hearing Officer*, TRA Docket No. 00-00998 (May 14, 2001).

¹³ *Response of Gasco to Show Cause Order*, TRA Docket No. 00-00998, p. 1 (May 25, 2001) (Gasco’s Response was incorrectly filed under “Docket No. 97-00293 and 97-00160.”).

¹⁴ *Id.*

action.”¹⁵ According to the Response, the Authority’s Order in Docket No. 99-00647 contains four (4) findings, including a finding of over-recovery of gas costs, and “‘Conclusion and Recommendations’ in which the Staff noted that it was ‘concerned’ that the amount of over-recovery from customers had ‘increased substantially’ during the audit period.”¹⁶ Gasco maintains:

Finally, the [1999] Report calculates a new, higher ACA adjustment factor which, **the Staff assumed**, the company would begin using in November, 1999 and continue using “until the next audit period.” But since the Report is only concerned with events occurring during the 1998-1999 audit period, the Report does not explicitly order Gasco to begin using the new adjustment factor or to take any other action during the 1999-2000 period. In fact, the only action the company is specifically requested to take is the “recommendation” that management investigate the imbalance between sales and purchases. The company did that.¹⁷

Gasco then states that the “next year’s Audit Report [covering the 1999-2000 period] noted that Gasco did not adjust the ACA factor in November, 1999, ‘due to a clerical error on the part of the company.’”¹⁸ Gasco argues:

Although the [2000] Report is critical of Gasco’s failure to adjust the ACA factor in November, 1999, the Report does not allege that Gasco violated any directive contained in the previous year’s Order. The Report merely notes that Gasco was “advised” of the correct figure and failed to incorporate that figure into Gasco’s bills in a timely fashion. While it remains to be seen whether Gasco’s “clerical error” might constitute a violation of some other order or rule and whether such violation is even a proper basis for a show cause Order, it is clear that Gasco’s failure to adjust the ACA factor does not constitute a violation of the 1999 Order or the 1998-1999 Audit Report.¹⁹

Finally, Gasco concludes:

In sum, there is nothing in the Staff’s 1998-1999 Audit Report – and nothing in the TRA’s 1999 Order adopting that audit – which specifically orders Gasco to do anything. The Report is **merely an audit** of the 1998-1999 period and contains various findings and conclusions concerning that period. Gasco agreed with those

¹⁵ *Id.*

¹⁶ *Id.*, p. 2.

¹⁷ *Id.* (Emphasis added.)

¹⁸ *Id.*

¹⁹ *Id.*, p. 3. (Emphasis in original).

findings and implemented the sole future conduct. Therefore, there is no basis for the Authority to issue a show cause order for “failure to comply” with the Authority’s November 24, 1999 Order. Gasco cannot properly be penalized for “failing to comply” with a TRA Order which contains no mandatory directives and only one hortatory “recommendation” which is unrelated to the current dispute.²⁰

Based upon the foregoing assertions, Gasco requests that the Authority’s Show Cause Order be dismissed.

The Staff’s Reply

In its Reply, the Staff states that “[r]ecommendations made in an audit report are directives that Gasco is obligated to address and take the appropriate corrective action.”²¹ The Reply focuses on the statement in the 1999 Report that “[t]he correct ACA adjustment factor to be applied to customer bills, beginning with the November 30, 1999 billing, is a negative \$0.5915.” The Reply states:

This statement clearly directs Gasco to use the amounts specified, starting at the time specified. Standing alone, the audit report may not have the full force and effect of an Order by this Authority. But once the Authority adopts the findings as their own, as they did in this case, the above statement made in the ACA Audit Report **becomes a required action for Gasco to take**. Failure to perform such action is a violation of the Final Order that approved, adopted and incorporated such audit report.²²

On this basis, Staff requests that Gasco’s request to dismiss be denied.²³

Discussion

Tenn. Code Ann. § 65-4-104 provides that the Authority “has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.” As provided in Tenn. Code Ann. § 65-2-102(a)(2), the Authority “is

²⁰ *Id.* (Emphasis added).

²¹ *Staff Reply to Response of Gasco to Show Cause Order*, TRA Docket No. 00-00998, p. 3 (June 1, 2001).

empowered to adopt rules implementing, interpreting, or making specific the various laws which it enforces or administers.”

The Authority’s Purchased Gas Adjustment (“PGA”) Rules, Authority Rules 1220-4-7-.01 through 1220-4-7-.05, were adopted by the TRA’s predecessor, the Tennessee Public Service Commission, pursuant to the Commission’s rulemaking authority, and became effective March 1, 1994. As stated in Authority Rule 1220-4-7-.02(2), the PGA Rules “are intended to permit the Company to recover, in a timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect Gas Costs from its customers.”

Authority Rule 1220-4-7-.02(4) provides that “[t]he rates for gas service set forth in all of the Rate Schedules of the Company **shall be adjusted** pursuant to the terms of the PGA, or any specified portion of the PGA as determined by individual Rate Schedule(s).” (Emphasis added). Authority Rule 1220-4-7-.03 sets forth the method by which the adjustment is to be calculated. As Authority Rule 1220-4-7-.03(1) states, “[t]he PGA shall consist of three major components: (a) the Gas Charge Adjustment; (b) the Refund Adjustment and (c) the Actual Cost Adjustment (ACA).” The 2000 Report provides the following explanation of the function of the ACA:

The ACA is the difference between the revenues billed customers by means of the [Gas Charge Adjustment] and the cost of gas invoiced the Company by suppliers plus margin loss (if allowed by order of the TRA in another docket) as reflected in the Deferred Gas Cost account. The ACA then “true-up” the difference between the actual gas costs and the gas costs recovered from the customer through a surcharge or a refund. The [Refund Adjustment] refunds the “true-up” along with other supplier refunds.²⁴

In order to ensure that the appropriate “true-ups” take place, the Staff conducts an annual compliance audit of Gasco. Each such audit results in an audit report, which the Staff files with

²² *Id.* (Emphasis in original).

²³ *Id.*, p. 4.

the Authority for approval and adoption. As the 2000 Report explains, “[t]he two basic reasons for compliance audits are to ensure compliance with the Uniform System of Accounts (USOA) and to assure that the utility is following all rules, regulations and directives adopted by the TRA.”²⁵ As the 2000 Report further states, “[t]he objective of this audit was to determine that Purchased Gas Adjustments, which are encompassed by the ACA and were described earlier, approved by the TRA during the period from July 1, 1999, to June 30, 2000, had been calculated correctly and were supported by appropriate source documentation.”²⁶

The purpose of the 2000 Report, as is the case with the reports issued in all of the Staff’s ACA compliance audits of the gas companies under the TRA’s jurisdiction, is to ensure that the Company complies with the PGA Rules. The compliance audit report provides the Company with the correct Refund Adjustment to be applied to its customers’ bills. The compliance audit report is not “merely an audit”; it does not simply represent the Staff’s “assumption” that the Company will apply the new adjustment factor stated in the audit report; and, Staff’s findings, once adopted by the Authority, are not “hortatory” proposals that can either be complied with or not at the Company’s whim. Under the terms of the PGA Rules, the Company cannot be in compliance with those Rules if it does not apply the correct Refund Adjustment.

Gasco is well aware of the purpose and operation of this process, having been the subject of five compliance audits to this point.²⁷ The Company has previously complied with directives in audit reports regarding correct “true-up” amounts without protest. It is incredible that the

²⁴ *Compliance Audit Report of Gasco Distribution Systems, Inc., Actual Cost Adjustment*, TRA Docket No. 00-00998, p. 2 (April 5, 2001).

²⁵ *Id.*

²⁶ *Id.*, p. 3.

²⁷ These compliance audits are in: TRA Docket No. 00-00998, covering the period from July 1, 1999 through June 30, 2000; TRA Docket No. 99-00647, covering the period from July 1, 1998 through June 30, 1999; TRA Docket No. 98-00607, covering the period from July 1, 1997 through June 30, 1998; TRA Docket No. 97-00293, covering the period from July 1, 1996 through June 30, 1997; and a previous audit having no docket number and covering the period from December 1993 through June 30, 1996.

Company would argue that directives in the Staff compliance audit reports are not enforceable or mandatory when those directives are incorporated in Authority orders approving and adopting those reports. The Company's insistence on specific language directing it to take certain actions ignores the overarching mandate of the PGA Rules, that the Company ensure compliance through "true-ups" by applying the adjustment amounts provided by the TRA Staff.

The Company also disregards the language in the 1999 Report and the Authority's November 24, 1999, Order which does direct the Company to take specific actions so that it will be in compliance with the PGA Rules. The 1999 Report states: "The **correct** ACA adjustment factor **to be applied** to customer bills, **beginning with the November 30, 1999 billing**, is a negative \$0.5915 (see attachment 2)."²⁸ The Staff filed the 1999 Report on October 21, 1999. The Authority considered, approved, and **adopted** the 1999 Report at the Authority Conference on November 2, 1999. An Order adopting and incorporating the 1999 Report was issued on November 24, 1999. Within that Order, Gasco was provided ten (10) days in which to file a petition for reconsideration. Gasco never challenged the 1999 Report, the Authority's consideration of the 1999 Report at the November 2, 1999, Conference, the Staff's filing of the 1999 Report, or the November 24, 1999, Order itself.

Contrary to Gasco's claim in its Response, the TRA gave clear direction to the Company to take specific action, absent which the Company would not be in compliance with the TRA's PGA Rules, in the 1999 Report. The Staff's compliance audit for the next audit period, reflected in the 2000 Report, found that the Company failed to comply with the Authority's directives. Notwithstanding Gasco's assertion that it was not aware of the action it was required to take, the Staff's 2000 Report identifies the actual reason for Gasco's non-compliance as the Company's

²⁸ *Compliance Audit Report of Gasco Distribution Systems, Inc., Actual Cost Adjustment*, TRA Docket No. 99-00647, p. 10 (Oct. 21, 1999) (Emphasis added).

admitted failure “to change its billing system to implement the correct factor upon receiving the Staff’s audit report.”²⁹ Based upon the uncontested findings in the 2000 Report, the Authority properly issued an Order, pursuant to Tenn. Code Ann. § 65-2-106, directing Gasco to show cause why it should not be penalized for non-compliance with the TRA’s November 24, 1999, Order in Docket No. 99-00647, in which the Authority adopted and incorporated the 1999 Report and the directives contained therein. Through the PGA Rules, the Staff’s Report, and the Authority’s Orders, Gasco was duly directed as to the correct ACA adjustment factor to apply, beginning with its November 1999 billing, in order to ensure compliance with the PGA Rules. Gasco needed no additional elucidation of these directives from the Staff or the Authority and certainly requested none.

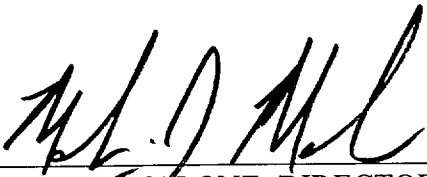
Based upon the foregoing findings, the Hearing Officer finds that Gasco’s request to dismiss the Authority’s show cause proceeding is without merit and is hereby denied.

IT IS THEREFORE ORDERED THAT:

1. Gasco’s request to dismiss the Authority’s show cause proceeding, as set forth in the Authority’s Order of May 14, 2001, is denied.
2. Any party aggrieved by the Hearing Officer’s decision in this matter may file a Petition for Reconsideration with the Hearing Officer within fifteen (15) days from the date of this Order.
3. Any party aggrieved by the decision of the Hearing Officer in this matter may file a Petition for Appeal with the Tennessee Regulatory Authority within fifteen (15) days from the date of this Order.

²⁹ *Compliance Audit Report of Gasco Distribution Systems, Inc., Actual Cost Adjustment*, TRA Docket No. 00-00998, p. 9 (April 5, 2001).

4. In the event this Order is not appealed to the Directors of the Tennessee Regulatory Authority within fifteen (15) days, this Order shall become final and shall be effective from the date of entry.



MELVIN J. MALONE, DIRECTOR
AS HEARING OFFICER

ATTEST:



K. David Waddell, Executive Secretary